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OFFICE OF FINANCIAL AND INSURANCE SERVICES
DEPARTMENT OF CONSUMER & INDUSTRY SERVICES
DAVID C. HOLLISTER, DIRECTOR

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COMMISSIONER

DATE: December 1, 2003

LETTER NO.: 2003-CU-09

TO: The Board of Directors and Management of Michigan State-Chartered Credit Unions

SUBJECT: 2003 Third Quarter Financial Results

The Office of Financial and Insurance Services (OFIS) compiles call report information to monitor Michigan state-chartered credit unions, both individually, and in the aggregate. The purpose of this letter is to share some overall industry trends and highlight certain areas of particular concern based on the September 30, 2003 call report filings. The following information and analysis does not include CenCorp Credit Union.

Summary

Overall, Michigan's 272 state-chartered credit unions remain in sound financial condition and continue to provide quality services to their members. Credit union membership remained stable for the quarter at just over 2.67 million. Assets declined during the third quarter for the first time in at least two decades. State-chartered credit unions now hold total assets of \$17.7 billion. Consolidated earnings remained stable with a Return on Average Assets (ROAA) of .85%, increasing the aggregate net worth ratio nearly 20 basis points to 10.68%. The number of institutions reporting net worth ratios less than 8% dropped from 30 as of June 30, 2003 to 23 at the end of September 2003. Lending picked up significantly from the first quarter with an annualized growth of 11.85%. Total loans now exceed \$10.3 billion. Loan delinquency and charge-offs remained stable overall, but the number of credit unions reporting a significant increase in delinquency and loan losses over the past twelve months remained high.

Asset Decline

The growth rate for all Michigan state-chartered credit unions fell to -0.79% (annualized) for the third quarter of 2003, in sharp contrast to the large increases reported for the first two quarters of 2003. Twelve credit unions reported annualized asset growth over 20% at September 30, 2003, less than one third of the number reported at June 30, 2003.

Areas of regulatory concern identified in our analysis of the September 30, 2003 call report information include the following:

More Credit Unions Report Increased Delinquency and Loan Losses

Overall delinquency and net charge-offs remained stable at 0.95% and 0.47% (respectively) during the quarter. However, seventeen credit unions had an increase in the net charge-off ratio of more than 100 basis points over the last twelve months. Twenty-four credit unions had a net

charge-off ratio over 1.5% at September 30, 2003, two more than June 30, 2003. Also, 37 credit unions had an increase in the delinquency ratio of more than 100 basis points over the last twelve months, compared to 32 reported last quarter. The number of credit unions with delinquency ratios exceeding 3% increased to 40.

Credit unions experiencing sharp increases in delinquency and loan losses should take immediate action to determine what factors, whether internal or external, contributed to the adverse trends. Policies and procedures should be developed to address these factors.

High Number of Institutions Reporting Net Worth Ratios Below 8%

While the net worth ratio in aggregate increased due to an overall decline in assets, 23 credit unions reported ratios below 8% as of September 30, 2003. Of those institutions, five meet “adequately capitalized” guidelines as defined by Part 702 of the NCUA’s Rules and Regulations. One institution is “undercapitalized,” and one “significantly undercapitalized.”

Conclusion

With interest rates poised to rise, management must remember that profitability may be reduced when the cost of shares increases, while the yield on long-term fixed rate mortgages remains flat. Prudent risk management practices are essential for credit unions to minimize the effects of interest rate risk.

Prudent risk management includes timely identification and quantification of potential risks and adverse trends, and taking appropriate steps to ensure risks are properly managed. Directors and management teams must monitor the financial condition of their credit union on an ongoing basis to ensure satisfactory performance and safe and sound operations are maintained.

A written plan of action should be developed when adverse trends or financial conditions are identified. This plan of action serves to document your board’s awareness of the problem and intended actions to control and correct the adverse conditions.

I hope the information in this letter is helpful in making informed business decisions. Operating a financial institution safely and soundly requires diligence in risk identification, measurement, and management. The stresses evident in the September 2003 statistics highlight the need for application of sound management practices in an increasingly uncertain economic environment.

Sincerely,

Roger W. Little, Deputy Commissioner
Credit Union Division